

Message Text

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FM USMISSION OECD PARIS

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SUBJECT: EDRC ANNUAL REVIEW OF SWITZERLAND JAN 30

REF: OECD DOC EDR(75)2

1. SUMMARY: SECRETARIAT EXPECTS CONTINUED SLOWDOWN IN ACTIVITY FOR SWITZERLAND IN 1975 WITH PRICES RISING SOMEWHAT LESS RAPIDLY THAN 1974. MAIN ISSUES FOR DISCUSSION AT ANNUAL REVIEW WILL BE LATEST SWISS FORECASTS AND THEIR POLICY IMPLICATIONS, PARTICULARLY ROLE OF ALTERNATIVE BUDGET AS BASIS FOR MORE STIMULATORY FISCAL POLICY AND ADVISABILITY OF RELAXING MONETARY POLICY TO BRING ABOUT REDUCTION IN INTEREST RATES AND ALLOCATE CREDIT ON MORE SELECTIVE BASIS. ON EXTERNAL SIDE, SECRETARIAT PROPOSES TO DISCUSS EFFECTS OF APPRECIATION OF SWISS FRANC ON EXPORT POTENTIAL, AND MEASURES WHICH MIGHT BE TAKEN TO RELIEVE PRESSURE ON EXCHANGE RATE, INCLUDING EXPECTED IMPACT RECENT SWISS RESTRICTIVE ACTIONS. ACTION REQUESTED: MISSION WOULD APPRECIATE COMMENTS OR QUESTIONS FROM WASHINGTON AND EMBASSY BERN IN TIME FOR ANNUAL REVIEW. END SUMMARY.

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2. GENERAL OUTLOOK: SECRETARIAT SEES CONTINUATION OF RECESSIONARY TENDENCIES IN 1975, WITH SLIGHT FALL IN OUTPUT, STAGNATION OF PRIVATE CONSUMPTION AND SHARP DROP IN INVESTMENT, ASSUMING CONTINUATION OF PRESENT RESTRICTIVE DEMAND MANAGEMENT POLICIES. SOME EASING IN LABOR MARKET IS ANTICIPATED BUT EMPLOYMENT SITUATION NOT EXPECTED TO BECOME SERIOUS PROBLEM. GROSS FIXED ASSET FORMATION WILL PROBABLY BE WEAKEST COMPONENT IN DOMESTIC DEMAND AS FIRMS FIND LESS INCENTIVE TO INVEST BECAUSE OF POOR DEMAND PROSPECTS, DECLINE IN CAPACITY FOR SELF-FINANCE, AND HIGH LEVEL OF INTEREST RATES.

3. PRICE OUTLOOK: SECRETARIAT EXPECTS UPWARD TREND OF PRICES TO BE MORE MODERATE IN 1975, WITH RATE OF INFLATION SLOWING TO ABOUT 8 OR 9 PERCENT FROM 10 PERCENT LEVEL OF 1974. MAIN REASONS FOR SLIGHTLY MORE OPTIMISTIC PRICE PICTURE ARE REDUCTION OF DEMAND PRESSURE AND PROSPECT FOR MORE MODEST WAGE INCREASES IN RESPONSE TO EASIER CONDITIONS ON LABOR MARKET.

4. BALANCE OF PAYMENTS: SECRETARIAT EXPECTS MODERATE DETERIORATION OF BALANCE ON CURRENT ACCOUNT AS SLOWDOWN IN GROWTH OF BOTH EXPORT AND IMPORT VOLUMES PROJECTED TO BE SOMEWHAT MORE SEVERE ON EXPORT SIDE. EXPORT EXPANSION WILL BE AFFECTED BY SLOWDOWN IN GROWTH OF MARKETS AND BY APPRECIATION OF SWISS FRANC, WHILE IMPORT VOLUMES EXPECTED TO RESPOND TO WEAKENING OF DOMESTIC ACTIVITY.

5. POLICY STANCE: SECRETARIAT RECOMMENDS THAT SWITZERLAND CONSIDER GRADUALLY ADJUSTING ITS PRESENT RESTRICTIVE FISCAL AND MONETARY POLICY STANCE TO PREVENT FURTHER GROWTH IN MARGIN OF SLACK AND AVOID POSSIBLE ADVERSE EFFECTS ON EMPLOYMENT. SECRETARIAT SEES DANGER OF FIRMS UNLOADING SURPLUS WORK FORCE IN EASIER CONDITIONS OF LABOR MARKET WHICH COULD CAUSE SIGNIFICANT RISE IN UNEMPLOYMENT IN 1975, ALTHOUGH IT WOULD NOT BE VERY HIGH AS PERCENTAGE OF LABOR FORCE IN COMPARISON WITH OTHER OECD COUNTRIES. SECRETARIAT NOTES EXISTENCE OF ALTERNATIVE "STIMULATORY" BUDGET WHICH COULD BE INTRODUCED DURING LIMITED OFFICIAL USE

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ING 1975 TO HELP ACHIEVE COUNTER-CYCLICAL OBJECTIVES. IT CONSIDERS THAT SUBSTANTIAL INCREASE IN PUBLIC INVESTMENT WOULD BE MOST APPROPRIATE METHOD OF SUPPORTING LEVEL OF ACTIVITY IN FACE OF EXPECTED FURTHER WEAKENING OF PRIVATE DEMAND IN 1975. SECRETARIAT DOES NOT BELIEVE THAT INCREASED TAXATION WOULD BE APPROPRIATE TO FINANCE SUCH EXPENDITURE UNDER PRESENT CONDITIONS OF DEPRESSED DEMAND, AND SUGGESTS THAT TEMPORARY PUBLIC DEFICIT DUR-

ING PRESENT PERIOD OF RECESSION WOULD BE ENTIRELY JUSTIFIED. IT SUGGESTS THAT SWITZERLAND CONSIDER ADJUSTING VARIOUS CAPITAL MARKET CONTROLS SO AS TO PERMIT FINANCING OF PUBLIC SECTOR DEFICIT WITHOUT CREATING STRAIN ON MONEY AND CAPITAL MARKETS. IN ADDITION, SECRETARIAT RECOMMENDS SOME RELAXATION IN MONETARY POLICY TO REDUCE LEVEL OF INTEREST RATES (ALSO RELIEVING UPWARD PRESSURE

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ON EXCHANGE RATE - SEE PARA 6 BELOW), AND SOME USE OF SELECTIVE CREDIT CONTROLS TO FAVOR AGRICULTURE AND HOUSING CONSTRUCTION.

6. EXTERNAL POLICY: SECRETARIAT IS WELL AWARE OF CRITICAL EFFECTS OF SWISS FRANC APPRECIATION ON SWISS EXPORTS AND HENCE ON LEVEL OF ACTIVITY AND EMPLOYMENT. REFDOC MENTIONS TWO-TIER EXCHANGE MARKET ACCOMPANIED BY DIRECT CONTROLS ON CAPITAL FLOWS AS ONE POSSIBLE APPROACH TO EXCHANGE RATE PRESSURES. IN ANY EVENT, SECRETARIAT BELIEVES THAT RELAXATION OF SWISS MONETARY

POLICY, RESULTING IN REDUCTION IN INTEREST RATES, WOULD NOT ONLY HELP TO MAINTAIN LEVEL OF DOMESTIC ACTIVITY BUT WOULD HELP TO AVOID NEED FOR DRASTIC EXCHANGE CONTROL MEASURES.

7. MISSION INTENDS TO FOCUS ON SCOPE FOR FISCAL AND MONETARY POLICY INITIATIVES AND PROSPECTS FOR FINANCING SECRETARIAT PROPOSAL FOR PUBLIC SECTOR DEFICIT. WE SHALL ALSO ASK ABOUT PROSPECTS FOR EXPORTS IN VIEW OF LIMITED OFFICIAL USE

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RECENT REDUCTION IN OECD AREA TRADE ESTIMATES TO NEAR ZERO GROWTH IN 1975, AND WHETHER WAGE DEMANDS WILL IN FACT BE MORE MODEST AT TIME OF HIGH INFLATION. MISSION WILL QUESTION SECRETARIAT'S RECOMMENDATIONS ON TWO-TIER EXCHANGE MARKET, IN LIGHT HISTORICAL LACK OF SUCCESS SUCH EXPERIMENTS (E.G. EXPERIMENTATION AND ABANDONMENT BY FRANCE AND ITALY). WE WOULD APPRECIATE ANY ADDITIONAL COMMENTS OR QUESTIONS WHICH WASHINGTON OR BERN MAY WISH TO PROVIDE, AND WE WELCOME PARTICIPATION AT MEETING BY SPILLANE.
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